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**DIRECTORATE OF  
INTELLIGENCE**

# Intelligence Memorandum

*The French Economy on the Eve of the Nixon-Pompidou Meeting*

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December 1971

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**CENTRAL INTELLIGENCE AGENCY**  
**Directorate of Intelligence**  
**December 1971**

**INTELLIGENCE MEMORANDUM**

**THE FRENCH ECONOMY**  
**ON THE EVE OF THE NIXON-POMPIDOU MEETING**

**Conclusions**

1. The French economy presently is the fastest-growing in Western Europe, as well as one of the most insulated from the effects of the new US economic policy. Its foreign trade position is strong, official reserves are above the level recorded prior to the riots and strikes of May 1968, and the rate of growth of real GNP is near 6%. Despite these strengths, however, the present international monetary crisis is having adverse effects on consumer and investor confidence. Moreover, consumer prices continue to increase at a rate far above that considered acceptable, and the growth of unemployment is becoming increasingly important as a political issue. France's economic prospects for 1972 remain good, if somewhat clouded with uncertainty. Much depends on a solution to the monetary crisis. The psychological and indirect economic effects of continued monetary confusion could lead to even greater investor indecision and dim the short-term economic outlook.

**Discussion**

**Domestic Economic Performance Since the Devaluation**

2. Following the August 1969 devaluation of the French franc, the newly-installed Pompidou government implemented an economic stabilization program. Although aimed mostly at the foreign sector, the program also included domestic fiscal restraints, a temporary price freeze, and tight credit controls. Most of the credit controls – involving high interest rates and relatively severe limitations on bank and installment lending – remained in effect through 1970. The anti-inflationary policy

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slowed the pace of economic activity, reducing the growth of real GNP to 6% in 1970 - a rate below the abnormally high 8% posted in 1969, but still above the 1965-68 average of 5%. Industrial growth lost momentum during 1970, and unemployment increased, reaching slightly more than 2% of the labor force by December (see the chart). However, because price increases resulted more from rapidly rising wage costs than from demand pressures, the rate of inflation was not slowed significantly. Wages in manufacturing grew by 11% during the year, and consumer prices rose 6%.

3. In general, these trends have continued through 1971. Although economic expansion is still more rapid in France than in its principal trading partners, French growth has slowed as a result of continued anti-inflationary policies, a pause in the investment boom, and a general slowdown in the growth of world trade. Although consumer demand remains relatively strong, excess demand no longer exists, primarily because of a decline in orders for durable goods. Real GNP will be up by about 5.5% in 1971 (compared with earlier, official projections of a 6.1% increase), reaching a level of \$165 billion. Industrial production in September was 6.3% above that of a year earlier, whereas full utilization of capacity would have resulted in an estimated 8% increase.<sup>(1)</sup> After remaining relatively steady at 2% of the labor force during the first half of 1971, the number of unemployed workers began increasing again in July and reached nearly 2.5% of the labor force in October.<sup>(2)</sup>

4. Inflation now appears to be virtually built into the system. Because of the touchy social climate prevailing since the disturbances in 1968, the French government has put little pressure on unions to moderate wage demands. Wages in manufacturing continue to increase at an annual rate of more than 11%, double the estimated 5.5% rise in industrial productivity for 1971. In addition, "wage indexing" -- linking wages to consumer prices and guaranteeing specified percentage increases in real income -- is now common throughout French industry. A six-month price-limitation agreement between the French government and major manufacturers, signed in mid-September and implemented on 1 October, has so far failed to show signs of slowing inflation. In the first month of implementation, consumer prices increased at an annual rate of 7.4%. Prices for those manufactured products directly covered by the agreement increased at an annual rate of only 5%, but this is approximately the same rate of increase they recorded earlier in the year. A price freeze on selected food products, announced near the end of October, is expected to have little effect on the overall rate of inflation.

1. France's rate of growth of industrial output compares very favorably with the rates achieved by its major competitors over the same period: United Kingdom, +2.4%; West Germany, +1.9%; and Italy, -7.3%.

2. These percentages, based on French definitions, are lower than would be obtained from estimates based on definitions used in the United States.

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### The Foreign Sector

5. Between May 1968 (the period of riots and strikes) and October 1969 (when Germany revalued its currency), France recorded huge deficits in its balance of payments and lost reserves at an alarming rate. Official reserves plunged to \$3.9 billion, a little more than half the \$7.0 billion recorded at the end of 1967. And even the \$3.9 billion included nearly \$3 billion borrowed from the IMF and foreign central banks. The 11% devaluation of the franc in August 1969, coupled with the 9.3% revaluation of the deutschemark two months later, immediately reversed this trend. In 1970, all major accounts of the French balance of payments recorded surpluses. The current account registered a relatively large surplus as traders resumed a more normal pattern of payment for imports and exports. In 1969, anticipating the devaluation of the franc and the revaluation of the deutschemark, French traders had accelerated payments for imports and postponed receipts for exports. As a result, net settlement of trade transactions reflected what was essentially a short-term capital outflow. The parity changes themselves eliminated the motivation for this type of speculative financing of trade. The surplus in the 1970 French balance of payments also reflected the return of some of the speculative short-term capital that had flowed out of the country in 1968-69 as well as France's return to its traditional position as a net recipient of long-term capital investment. By the end of 1970, official reserves had increased by \$1.1 billion, to a total of \$5 billion. The improvement, however, was much greater than that indicated: during the year, France had paid off more than \$2 billion in official debts.

6. The competitive advantage gained by the devaluation also helped reduce the deficit in the merchandise balance of trade in 1970 and 1971 (see the chart). Despite rapidly increasing production costs, which have resulted in pressures to boost export prices, French exporters have been able to maintain most of the price advantage gained by the devaluation. Export prices have been rising worldwide because most of the world's leading trading nations are experiencing inflation comparable with that in France. In addition, French exporters, with generally larger profit margins than their competitors, have found it easier to absorb additional costs rather than pass them on in the form of higher prices.

7. In 1971, France again was forced to deal with international payments problems -- this time, however, as a result of speculation concerning a franc revaluation. During the first half of the year, the French balance of payments recorded a surplus of more than \$1 billion. Although part of this surplus reflected the continued strengthening of the basic French payments position, most of it was the result of speculation that the franc would be revalued. In the first four months following the deutschemark

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float in early May, the Bank of France was forced to purchase more than \$2 billion in speculative funds to maintain the official parity of the franc. Most of this purchase occurred in July and August.

8. In an effort to halt speculation, France implemented a two-tier exchange market system on 23 August, maintaining the franc at its official par value for commercial transactions but allowing it to float relatively freely for financial and speculative transactions. Such a dual system generally is effective only if it is supplemented by an extensive and efficient exchange control system - and if speculative pressure is not large. These conditions were met in France until late in November, when rumors of an impending dollar devaluation forced the Bank of France to purchase \$400 million to \$500 million in speculative money to support the commercial franc. At the end of November 1971, French official reserves were probably more than \$7.5 billion, the highest level in history.

Problem Areas

9. Within France's basically strong economy, several nagging problems persist. The most vexing is chronic inflation. The upsurge of prices would quickly have serious effects on French trade if most other industrial countries were not also experiencing rapid inflation. Because of their deep institutional and political roots, inflationary pressures are likely to continue.

10. A matter of more recent concern is unemployment, which lately has climbed to nearly 2.5% of the labor force. More people appear to be looking for work now than at any time in the last decade. Labor mobility is low in France, and unemployment compensation schemes are not very effective. Therefore, government officials and labor leaders become concerned when the unemployment rate exceeds 2%. They are especially sensitive to this issue now that campaigning for the 1973 legislative elections is under way.

11. With only 5% of its total exports going to the United States and with foreign trade playing a relatively small role in the economy, France is well-insulated from the direct effects of the new US economic policy. French businessmen, therefore, initially were relatively sanguine about the US economic decisions of 15 August. Although expressing fears of an international trade war if a solution were not reached quickly, they generally expected an early settlement. This optimism was dispelled, however, first by the continuing monetary impasse, and second by the French press. In October, the press - almost in unison - began printing a barrage of news items and editorials on present economic conditions. The risks of a world depression were discussed at length, and rising unemployment became front-page news.

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12. The atmosphere of crisis is having adverse effects on consumer and investor confidence. Since 15 August, several major investment projects have been postponed, durable goods orders are down, the French stock exchange index has dropped 20%, and the French are saving at a near-record rate. The most recent surveys of business opinion and capital spending plans indicate a substantial downward revision of short-term forecasts for economic growth. Although international monetary conditions can be held directly responsible for few of France's present economic problems, the crisis appears to have brought back to the surface a basic uneasiness concerning the long-term prospects for the economy, which has existed in France since the spring of 1968. In response to this uncertainty, the French government recently announced several measures designed to stimulate investment and exports, primarily through a general lowering of interest rates. There will probably be little upturn, however, until a solution to the monetary crisis is reached.

13. The crisis fever now appears to be abating somewhat, in response to announcement of President Nixon's series of talks with heads of state and to the most recent Group of Ten meeting. However, if a solution is not reached before the end of the year, it is likely that fears of a trade war and economic depression again will intensify.

**Short-Term Prospects**

14. The present economic uncertainty in France, which is due largely to the unsettled world monetary situation, makes short-term forecasting particularly hazardous. Official predictions, corroborated by most international economic organizations, are for a further slight slowdown of French economic growth in 1972, to somewhat more than 5% (from 5.5% in 1971). Although the French government is optimistically predicting a 1972 inflation rate of only 3.9%, its predictions have been consistently low since 1968. Prices probably will continue to rise at approximately the same annual rate as in 1971 - that is, somewhat more than 5%.

15. France's balance-of-payments position should remain strong in 1972. Currency floats by virtually all of France's major competitors have resulted in an effective devaluation of the franc by about 5%, enhancing France's competitive position. A currency realignment along the lines discussed in the most recent Group of Ten meeting would maintain most of France's advantage. Currency revaluations by the Netherlands, Belgium, and West Germany (which together account for 40% of French exports) would more than offset the adverse impact on French trade of a dollar devaluation.

16. For the short-term, however, the trade gains or losses that would result from currency realignment are less important to France than an end

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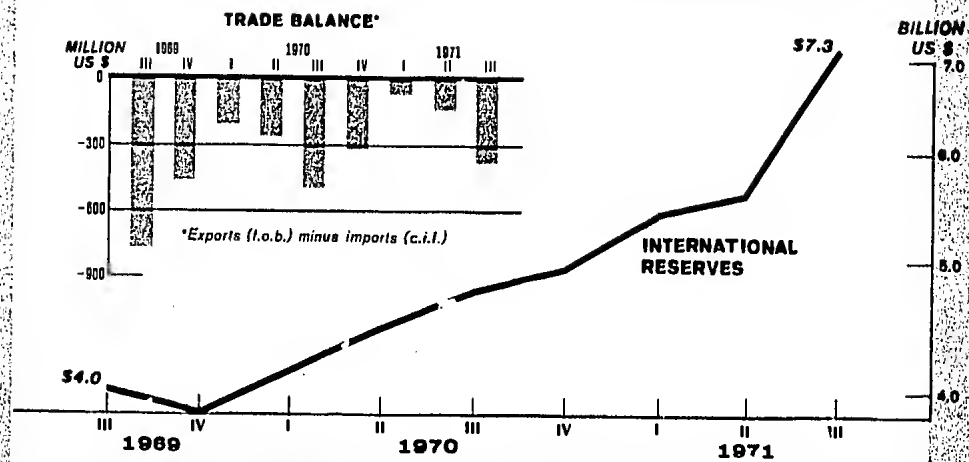
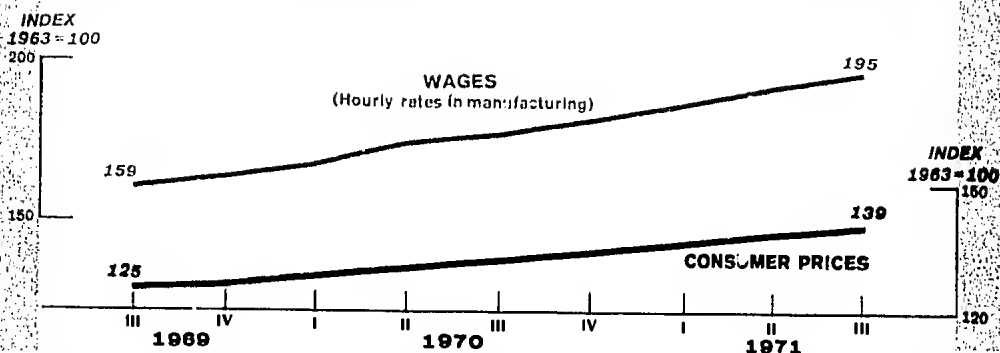
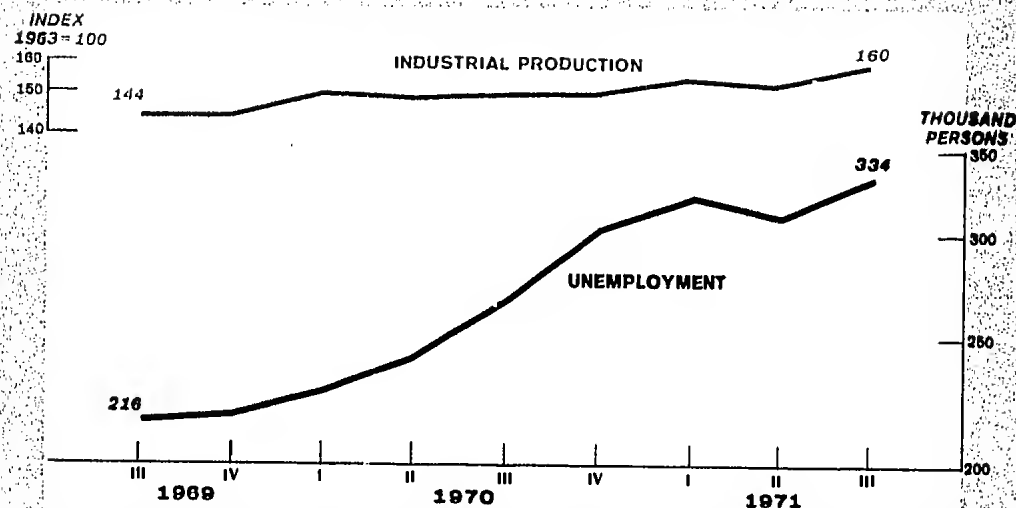


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to monetary uncertainty. The French economy could not escape the depressing effects of a further economic slowdown in other major European countries. There would be an impact on French trade and, even more important, further damage to the already fragile state of business confidence. In such a circumstance, all short-term forecasts of French economic growth, output, and trade would have to be revised downward, perhaps substantially.

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# FRANCE: Selected Economic Indicators



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